



BANKRUPTCY NEWS

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ADVERSARY ACTIONS

Lehman accuses JPMorgan of 'siphoning' billions

In re Lehman Bros. Holdings Inc. et al., No. 08-13555; *Lehman Bros. Holdings Inc. et al. v. JPMorgan Chase Bank N.A.*, Adv. No. 10-03266, adversary complaint filed (Bankr. S.D.N.Y. May 26, 2010).

Bankrupt Lehman Bros. Holdings says JPMorgan Chase Bank used its insider position to strip Lehman of billions of dollars in desperately needed assets in the days just before the investment bank's historic collapse.

According to Lehman's adversary complaint, filed in the U.S. Bankruptcy Court for the Southern District of New York, JPMorgan was the primary clearing bank for Lehman's broker-dealer business. That position allegedly

(See *ADVERSARY ACTIONS* on page 7)

ESTATE PROPERTY

Defunct banking firm's ex-exec's can tap D&O policy for defense costs

In re Downey Financial Corp., No. 09-13041, 2010 WL 1838565 (Bankr. D. Del. May 7, 2010).

Downey Financial Corp.'s former officers can access the defunct bank holding company's D&O insurance to pay for their defense against charges that they hid from investors the extent of Downey's exposure to risky subprime loans, a Delaware bankruptcy judge ruled May 7.

U.S. Bankruptcy Judge Christopher S. Sontchi found that the policy proceeds (the funds available to pay claims) are not the property of the estate of the debtor company, and even if they were, the officers can claim their share of them since they were covered under the policy.

The District of Delaware judge addressed a controversial overlap of bankruptcy and insurance law concerning whether a bankrupt company or its officers and directors are first in line for what is often one of the firm's last remaining assets: its insurance policies.

(See *ESTATE PROPERTY* on page 8)

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CRAMDOWN

Debtors can't escape balance owed on surrendered car, 2nd Circuit says

AmeriCredit Financial Services Inc. v. Tompkins et al., No. 09-0022, 2010 WL 1959532 (2d Cir. May 18, 2010).

Chapter 13 debtors who surrendered their automobile to a lender are on the hook for the difference between the amount owed on the loan and the amount the lender received from the sale of the car, the 2nd Circuit has ruled.

The unanimous panel said the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which prohibits debtors from bifurcating automobile loan debts into secured and unsecured portions, did not abolish lenders' state law claims to the deficiency between the unpaid loan balance and the value of the car.

The issue of what happens under the law when the market value of a car falls short of the loan balance has divided bankruptcy courts across the country.

The 2nd U.S. Circuit Court of Appeals joined the 6th, 7th and 8th circuits, which recently have ruled that lenders retain unsecured deficiency claims. In *re Long*, No. 06-6252, 519 F.3d 288 (6th Cir. Mar. 4, 2008); In *re Wright*, 492 F.3d 829 (7th Cir. July 3, 2007); In *re Osborn*, 515 F.3d 817 (8th Cir. Feb. 5, 2008).

The 2nd Circuit was faced with the case of Jesse and Sonja Tompkins, who filed for Chapter 13 protection in the U.S. Bankruptcy Court for the Southern District of New York in February 2008.

Shortly after filing, the Tompkinses surrendered their 2006 Chevrolet Impala to AmeriCredit, which held the couple's loan on the vehicle. Their Chapter 13 plan proposed that they surrendered the Impala in full satisfaction of the loan.

Meanwhile, AmeriCredit sold the car and filed a general unsecured claim for \$15,374, representing the loan balance less the amount it received from the sale. AmeriCredit objected to the Tompkinses' plan, while the couple objected to the lender's unsecured claim.

The Bankruptcy Court overruled AmeriCredit's objection, expunged its claim and confirmed the Tompkinses' plan. AmeriCredit appealed.

Before BAPCPA was enacted, a debtor could "cram down," or divide an automobile loan debt into a secured portion for the car's market value and an unsecured portion for the amount of the loan exceeding that value.

Seeing cramdown as a source of abuse, Congress added an unnumbered paragraph after Section 1325(a)(9) in BAPCPA, designed to force debtors who want to keep their cars to pay loans in full before paying other creditors.

BAPCPA tightens the rules for automobile loans made for "personal use" vehicles within 910 days of filing bankruptcy.

A number of bankruptcy judges have interpreted the new law to bar the division of the loans into secured and unsecured portions, thus allowing a debtor to give the car back in full satisfaction of the debt.

Writing for the 2nd Circuit panel, Judge Debra Ann Livingston noted that the courts in Long, Wright and Osborn reversed the trend. Those courts held that the BAPCPA gap is filled by state laws allowing lenders to sell repossessed vehicles, apply the proceeds to the debts and sue the borrowers for the balance.

Judge Livingston said that nothing in Section 1325 says a secured claim is fully satisfied by the surrender of the collateral. Both state law and the contract between the parties give AmeriCredit a right to a claim for the deficiency, she said.

"In the absence of a controlling bankruptcy provision, however, the rights of the creditor under state law are not disturbed," the judge added.

See RUTTER GROUP PRAC. GUIDE: BANKRUPTCY (The Rutter Group 2009): 2:32-33; 12:114; 13:372; 13:641; 13:741; 13:765-766; 13:956; 18:221; 18:235; 18:237; 18:245; 18:250; 18:252 (11 U.S.C. §1325(a)(9))
18:245.3 (In re Wright)

DISCHARGES

5th Circuit OKs drawdown to satisfy electricity retailer's debt

In re Texas Commercial Energy; Electric Reliability Council of Texas Inc. v. May, No. 08-40890, 2010 WL 1930254 (5th Cir. May 13, 2010).

An electricity retailer's discharge of pre-bankruptcy invoices owed to an energy supplier did not bar the supplier from drawing down a letter of credit securing a debt required to be paid by the retailer's reorganization plan, the 5th U.S. Circuit Court of Appeals has ruled.

The appeals panel said the drawdown by wholesale electricity supplier Electric Reliability Council of Texas

did not amount to an improper collection on a pre-petition invoice or obligation owed by Texas Commercial Energy.

Rather, ERCOT properly collected on a new obligation created by TCE's reorganization plan, the appeals court said.

According to the panel's opinion, Texas deregulated its energy markets in 2002, allowing customers to purchase electricity from their chosen retailer. TCE was one those retailers. It purchased its electricity wholesale from ERCOT, which manages the state's electric grid and market.

Volatility in energy prices soon caused TCE to falter and default on \$30 million in invoices owed to ERCOT, the opinion said.

The electricity retailer filed for Chapter 11 protection in March 2003 in the U.S. Bankruptcy Court for the Southern District of Texas.

To keep operating, it assumed its contract with ERCOT, with the Bankruptcy Court entering an order prohibiting ERCOT from collecting on the pre-petition debt.

In December 2003 the Bankruptcy Court confirmed TCE's reorganization plan, which provided ERCOT a \$14.8 million unsecured claim based on the pre-petition invoices.

The plan required TCE to make periodic payments on the unsecured claim and incorporated the earlier order barring ERCOT from collecting on the pre-petition invoices.

The plan further required that TCE post security following confirmation to guarantee its post-petition purchases from ERCOT.

However, because TCE lacked the resources to post sufficient collateral, the company's principal, Leo Leonard May, personally posted a \$900,000 letter of credit from Wells Fargo Bank, according to the opinion.

After confirmation TCE's financial troubles continued, and the company defaulted on the periodic payments to ERCOT required by the plan. However, the electricity retailer remained current on its post-petition invoices, the opinion said.

In response ERCOT drew down the \$900,000 letter of credit, and Wells Fargo sought repayment from May.

May then sued ERCOT in the Bankruptcy Court. He meanwhile repaid Wells Fargo with a promissory note, paying interest during the pendency of the litigation.

In his suit May alleged ERCOT, by drawing down the letter of credit, breached its contract with TCE and violated the court order incorporated into the reorganization plan barring the wholesaler from collecting on the pre-petition invoices.

Ultimately, the Bankruptcy Court awarded May \$900,000 in contract damages to satisfy the promissory note, \$169,400 in interest paid during the litigation, and \$178,300 in prejudgment interest.

It also found ERCOT in contempt for violating the order incorporated into the plan and awarded May his attorney fees.

After the U.S. District Court for the Southern District of Texas affirmed the decision, ERCOT appealed to the 5th Circuit, which reversed the lower courts' rulings.

Writing for the panel, Judge Edith H. Jones said TCE's pre-petition debt was "discharged and extinguished" on confirmation of the reorganization plan. However, the plan "replaced and superseded" TCE's pre-petition obligations with "restructured debt," she said.

"By changing the payment terms and amount of ERCOT's pre-petition invoice debt, TEC assumed a new debt in accordance with the TCE plan," she said.

Thus, the injunction barring the collection of pre-petition debts did not apply to the debt payments TCE was required to make under the plan, the panel concluded.

See RUTTER GROUP PRAC. GUIDE: BANKRUPTCY (The Rutter Group 2009): 22:1080-1084; 22:1090-1103 (eligibility for dischargeable debts under Chapter 11 discharge)

PETITIONS

Garlock, citing asbestos suits, files for bankruptcy protection

In re Garlock Sealing Technologies LLC, No. 10-31607, petition filed (Bankr. W.D.N.C. June 5, 2010).

Garlock Sealing Technologies, citing "double-dipping" by asbestos claimants, has filed for Chapter 11 bankruptcy protection.

It filed its petition June 5 in the U.S. Bankruptcy Court for the Western District of North Carolina.

The company said existing bankruptcy trusts have adopted procedures that allow asbestos claimants to

conceal their claims while also collecting payments from Garlock in the tort system for injuries caused by former defendants.

The "top tier" defendants, "companies that paid most of the plaintiffs' damages because they produced and sold huge quantities of highly friable asbestos products," began seeking bankruptcy protection around 2000 and stopped paying asbestos claims in the tort system, Garlock said in a press release.

According to the company, more than \$1 billion of annual settlement payments were lost to bankruptcy, and many plaintiffs began identifying Garlock's non-friable sealing products as a primary cause of their asbestos diseases.

The asbestos bankruptcy trusts established by top-tier defendants have assets exceeding \$20 billion to compensate claimants with asbestos diseases caused by those companies' products, Garlock says. It anticipated obtaining significant reductions in the costs to defend against and resolve claims as a result of those trust assets.

However, "[t]here is no prospect in the foreseeable future for trust reform that Garlock believes would give it the opportunity to receive a fair resolution in the tort system of asbestos claims against it."

By filing under Chapter 11, the company said, it will be entitled to have its responsibility for present and future asbestos claims fairly determined. This would include evidence of plaintiffs' exposure to friable asbestos products of former defendants that have established trusts and "were the most likely causes of [the plaintiffs'] diseases," Garlock said.

A fairly valued trust would cost Garlock less than remaining in the tort system, according to Steve Macadam, president and CEO of Garlock parent EnPro Industries.

Garlock said it will negotiate with representatives of asbestos claimants to establish a trust, but absent a resolution, it will ask the Bankruptcy Court to determine the amount necessary to fund the trust.

See RUTTER GROUP PRAC. GUIDE: BANKRUPTCY (The Rutter Group 2009): 2:239-244 (Chapter 11)
11:345 (automatic stay)
11:477; 11:479 (appointment of creditors' committee)
11:1020-1025 (disclosure statement)

REORGANIZATION PLANS

Labor Department seeks to block Tribune plan

In re Tribune Co. et al., No. 08-13141, objection to disclosure statement filed (Bankr. D. Del. May 13, 2010).

The U.S. Labor Department has objected to Tribune Co.'s reorganization plan, insisting it would block claims over the alleged misuse of the company's employee stock ownership program to fund Sam Zell's 2007 leveraged buyout of the now-bankrupt media conglomerate.

The agency says in an objection filed May 13 in the U.S. Bankruptcy Court for the District of Delaware that Tribune's reorganization plan would improperly relieve Zell and others from liability on claims over the use of the employee stock ownership plan, or ESOP.

Labor Department officials are currently investigating whether Zell and other parties involved in the buyout breached their fiduciary duties under Title I of the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001. If the agency determines that violations occurred, it could press claims against those involved, including Zell.

The Chicago-based Tribune owns numerous television stations and newspapers, including the Chicago Tribune and the Los Angeles Times. It filed for Chapter 11 protection in December 2008, less than a year after Zell's \$8.2 billion leveraged buyout took the company private.

The debt on the financing for the buyout was not secured, but the lenders allegedly obtained guarantees of the debt from many of Tribune's subsidiaries. The guarantees gave the LBO financing priority over the company's pre-existing debt.

The 2008 buyout has been a focal point of the bankruptcy proceedings, with bondholders and other creditors alleging it was a "fraudulent conveyance" made when Tribune was insolvent.

A bankruptcy examiner has since been appointed to examine the LBO.

Meanwhile, Tribune filed its reorganization plan and accompanying disclosure statement April 12. It then

sought court approval of the disclosure statement, which was mailed to creditors who will vote on the plan.

Under the plan, the ESOP would terminate and the shares held in employee accounts would be extinguished.

In its objection the Labor Department cites a recent decision by another federal court in a lawsuit by a group of current and former Tribune employees against Zell and others involved in the buyout over the use of the ESOP.

In *Neil v. Zell*, 677 F. Supp. 2d 1010 (N.D. Ill. Mar. 11, 2010), U.S. District Judge Rebecca R. Pallmeyer of the Northern District of Illinois rejected a motion to dismiss claims for breach of fiduciary duty and federal law violations against Zell; his company, EGI-TRB LLC; and the ESOP's trustee, GreatbancTrust Co.

The Labor Department says Judge Pallmeyer concluded that the involvement of the Tribune ESOP in the leveraged buyout "appears to have been improper and in violation of ERISA."

According to the department, the judge held that if the allegations made by the plaintiffs in are taken as true, "the sale of unregistered stock to the ESOP as part of the failed leveraged buyout constituted a prohibited transaction under Section 406(a) of ERISA."

The Labor Department says that in light of Judge Pallmeyer's decision, the current and former employees' claims seem to be strong.

However, the disclosure statement "fails to fully and clearly state that it wrongfully seeks to preclude the ESOP and its participants from obtaining any relief," the agency says.

Instead, Tribune proposes to release parties, including the defendants in the Neil case, from recovering on their claims and also attempts to subordinate the ERISA claims to those of other unsecured creditors, according to the objection.

See RUTTER GROUP PRAC. GUIDE: BANKRUPTCY (The Rutter Group 2009):
11:156-158 (strategies and tactics for unsecured creditors under Chapter 11)
11:477 (mandatory unsecured creditors' committee)
11:1020-1025 (Chapter 11 disclosure statement)
1:580 (fraudulent conveyance action as "core" bankruptcy proceeding)

NEWS IN BRIEF

Trustee fires back against Dreier's ex-wife in fee dispute

The trustee liquidating Marc Dreier's estate is fighting an objection to his fee request filed by the convicted fraudster's ex-wife, who argues that her \$7.1 million domestic support award should take priority. Salvatore LaMonica, who is divvying up Dreier's assets, says his fee request is senior to any claim Elisa Dreier could have under the Bankruptcy Code. LaMonica is seeking nearly \$277,000 in commissions and expenses, which is less than half of what he is entitled to, according to the response. The trustee adds that he has already paid Elisa Dreier \$106,000 on her claim for pre-bankruptcy support owed by her ex-husband. That payment is conspicuously absent from the objection, LaMonica says. Elisa Dreier argues in her objection that the 2008 award covering alimony and support for herself and the couple's two children is entitled to the highest priority status. Marc Dreier is serving a 20-year prison sentence after pleading guilty to charges stemming from an elaborate Ponzi scheme.

In re Dreier, No. 09-10371, trustee's response to objection to fee request filed (Bankr. S.D.N.Y. May 28, 2010).

Bankruptcy filings reach highest level since 2006

Bankruptcy filings for the 12-month-period that ended March 31 rose 27 percent from the previous year, reaching levels not seen since 2006, according to the Administrative Office of the U.S. Courts. A report released May 14 shows that bankruptcy filings rose to 1,531,997, from the 1,202,395 cases filed in the 12-month period ending March 31, 2009. That is the highest amount of filings since the period ending March 31, 2006, which included the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act. Filings spiked to 1,794,795 that year as debtors rushed to avoid the new law's strict controls on bankruptcy eligibility. According to the latest data, business filings rose 25 percent, while non-business filings increased 28 percent. The statistics show significant rises in all four bankruptcy chapters, with Chapter 7 filings rising 34 percent, Chapter 13 filings rising 12 percent, Chapter 11 filings rising 30 percent and Chapter 12 filings rising 65 percent. The report is available at http://www.uscourts.gov/News/NewsView/10-05-14/Bankruptcy_Filings_Highest_Since_2006.aspx.

Former Refco board members to forfeit \$39 million

Former Refco directors Edwin L. Cox Jr. and William L. Graham have agreed to settle a civil forfeiture suit by turning over \$39 million to the U.S. government. Federal prosecutors filed the suit in Manhattan federal court, saying the money was directly traceable to a criminal fraud scheme that led to the commodity brokerage's collapse in 2005. Cox and Graham were not charged with wrongdoing. The criminal case accused Refco ex-CEO Phillip Bennett and other top executives of cooking the company's books to facilitate a \$1.8 billion merger deal in 2004. \$39 million of that money ended up in trusts controlled by Cox and Graham, prosecutors said. The men agreed to forfeit the money, provided authorities recommend using it to pay victims of the fraud, prosecutors said.

United States v. \$35,100,000 ... and \$3,900,000 in United States Currency et al., No. 10-CV-3743, settlement announced (S.D.N.Y. May 7, 2010).

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(ADVERSARY ACTIONS continued from page 1)

gave JPMorgan “unparalleled access” to inside information about Lehman’s faltering financial condition.

“On the brink of [Lehman’s] bankruptcy, JPMorgan leveraged its life-and-death power ... to force [Lehman] into a series of one-sided agreements and to siphon billions of dollars in critically needed assets,” the complaint says.

The effect of the transactions was to “leapfrog” JPMorgan over other creditors, while “accelerating [Lehman’s] freefall into bankruptcy by denying it an opportunity for a more orderly wind-down,” the bankrupt investment bank alleges.

JPMorgan did not respond to a request for comment. Also, as of press time, it had not responded to the complaint.

Lehman filed the largest Chapter 11 bankruptcy ever Sept. 15, 2008, in the Southern District of New York.

According to the complaint, JPMorgan was the primary clearing bank for Lehman in the eight years before the bankruptcy, serving as the intermediary for the vast majority of the trades and repurchases conducted by Lehman’s brokerage unit.

JPMorgan acted as custodian over the cash and securities involved until the counterparties delivered their matching parts of the transaction.

In this position, JPMorgan’s top executives were “the ultimate insiders to the evolving crisis, enjoying real-time access to the key decision-makers at the United States Treasury and the Federal Reserve Bank of New York,” the complaint says.

The lawsuit says that insider access made JPMorgan grow increasingly concerned about Lehman’s financial condition. It also learned that the government would not be bailing out Lehman.

JPMorgan then allegedly forced Lehman to execute a guaranty of the clearing obligations of its brokerage unit and enter an agreement securing its obligations under the guaranty.

The agreements were purportedly signed in the early hours of Sept. 10, 2008 — just minutes before Lehman’s earnings report was made public, signaling its dire condition.

The complaint says JPMorgan extracted the agreements by threatening to cut off Lehman’s ability to clear trades.

In addition, Lehman says, JPMorgan made repeated demands for increases in collateral payments in the days leading up to its collapse, grabbing \$8.6 billion in the last four days before Lehman’s bankruptcy filing, including \$5 billion on the final business day.

These “unjustified” demands for additional collateral severely constrained Lehman’s liquidity, forcing it to file bankruptcy and robbing Lehman and its creditors of billions of dollars in value, the complaint says.

Among other things, Lehman alleges the execution of the guaranty and security agreements and payments of additional collateral were fraudulent or preferential transfers recoverable under the Bankruptcy Code and applicable state laws.

Lehman is seeking to recover the collateral payments. It also wants JPMorgan’s claims arising from the agreements to be disallowed or subordinated to those of other creditors.

The lawsuit comes in the wake of a report by Lehman examiner Anton Valukas, who was appointed by the Bankruptcy Court to investigate the investment bank’s collapse.

While Valukas faulted Lehman’s management over certain accounting practices that hid its financial condition and deceived investors, he said Lehman may have colorable claims against JPMorgan regarding the collateral payments.

See RUTTER GROUP PRAC. GUIDE: BANKRUPTCY (The Rutter Group 2009):

20:91 (complaint required for adversary proceedings)

1:98; 1:147; 1:580; 1:656; 2:466; 2:660; 3:86; 4:1036; 5:836; 5:2431; 6:224; 6:242; 8:1163; 11:245; 13:70-71; 13:199; 15:57; 15:74; 15:76; 17:1594; 20:21; 20:79; 21:1; 21:6; 21:15; 21:25; 21:35-36; 21:54; 21:75; 21:77; 21:145; 21:153; 21:259; 21:960; 21:962-963; 21:983; 21:1010; 21:1015; 21:1017; 21:1105; 21:1135; 21:1142; 21:1154; 21:1175; 21:1177; 21:1190; 21:1195-1196; 21:1211; 21:1311; 21:1520; 21:1556; 21:1570; 23:53 (11 U.S.C. § 548)

21:127; 21:134; 21:1047; 21:1060-1061 (11 U.S.C. § 548(a)(1)(B))

1:147; 5:2432; 7:55; 15:57; 15:74; 15:76; 17:900; 17:1396; 17:1594; 21:15; 21:25; 21:29; 21:58; 21:77; 21:1275; 21:1556; 21:1559-1560; 21:1562; 21:1572; 21:1585; 21:1651; 22:1134; 23:53 (11 U.S.C. § 550)

1:147; 5:836; 5:2431; 6:224; 6:242; 8:37; 8:760; 10:173; 11:246; 13:70; 13:72; 13:200; 15:57; 15:74; 15:76; 17:993; 21:1; 21:3; 21:15; 21:25; 21:35-36; 21:51; 21:92; 21:111; 21:116-118; 21:127; 21:145; 21:200; 21:221; 21:271; 21:288; 21:326; 21:1041; 21:1178; 21:1520; 21:1556; 21:1570; 23:53 (11 U.S.C. § 544)

(ESTATE PROPERTY continued from page 1)

That question has split federal appeals courts, but the answer was more simple than usual here, Judge Sontchi said. The corporate entity is not named in the case against the executives and therefore does not need the money to defend itself, he said, so the officers and directors should have access to it.

In the underlying actions, Downey shareholders said they lost their total investments because the company's executives did not disclose that the bank consistently made subprime loans to borrowers who lacked the ability to repay the debts.

They also said they were not informed about the extent of Downey's issuance of "option ARMs," exotic adjustable-rate mortgages that allow subprime borrowers to pay as much as they want during the initial term, with the unpaid amounts added to the loan balance. These loans often end up in default.

The shareholder suits, filed in May and June 2008, made state law breach-of-duty and federal securities law charges, but both types of suits centered on allegations that Downey had more than \$12 billion worth of option ARMs on its books and that the executives knew these loans were risky.

The securities fraud charges were dismissed, but the derivative state law claims have now been taken over by the bankruptcy trustee, who is pursuing them against the officers and directors in the name of the company's estate.

At issue is the \$10 million available under an insurance policy written for Downey by National Union Fire Insurance Co. The policy covers both the corporate entity and the directors and officers.

The executives have asked Judge Sontchi to let them tap the policy proceeds, but the trustee opposes that move, arguing that the policy belongs to the debtor.

The judge said the guiding principle in this type of case is that if the officers and directors can use the policy proceeds without diminishing the money that the company itself might need, they should have access to it.

Since Downey itself is not a defendant in the derivative action, it does not need the money and loses nothing when the directors and officers get a benefit they were promised when they signed on, Judge Sontchi said.

See RUTTER GROUP PRAC. GUIDE: BANKRUPTCY (The Rutter Group 2009):

21:476 (In re Allied Digital Technologies Corp.)

3:163; 8:205; 8:207-208; 8:230; 8:360; 8:485; 8:562; 8:676; 8:741; 13:1172 (11 U.S.C. § 362(a)(3))

3:165; 3:490; 5:2268; 8:1050; 8:1060-1061; 8:1063-1064; 8:1217; 8:1219; 8:1261; 8:1316; 8:1351; 8:1353; 8:1357; 8:1390; 8:1646-1647; 8:1666; 14:496; 14:553; 16:65; 16:726; 17:690 (11 U.S.C. § 362(d)(1))

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